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THE CHINA MARKET

HOW MUCH SUBSTANCE TO THE DREAM?

by Peter H. Calkins



In Guangdong Province:

NORTH AMERICAN FARM INTERESTS have long hoped that China would become a huge importer of agricultural products. However, these hopes have been mixed with bewilderment as China's development policies have shifted.

In 1987 alone, Hu Yaobang, a key reformer, was obliged to step down from power following the student protest of late 1986. Then in October, the 13th Party Congress saw the inclusion of increased numbers of conservative Marxists and moderate reformists on the Party's Standing Committee and in the Politburo. Reformers nevertheless strengthened their control of key political positions under Deng Xiaoping and Zhao Ziyang.

Do these cross-currents signal the end of the strong 9-year reformist momentum which has spread from rural to urban areas since 1978? Or does the inclusion of several conservatives by the

dominant reformers represent a brilliant short-term concession to guarantee the long-term success of the new policies? And what does all this mean for agricultural trade prospects between North America and China?

The Dream Is Still A Dream

It seems likely that the dream of China offering an unlimited market for North American agricultural products will remain a dream, at least for the rest of this century. Why? There are four basic reasons for caution in our efforts to expand agricultural trade with the globe's most populous nation.

First, instability and unpredictability of domestic policies in China will continue to undercut the effectiveness of trade programs. Unfortunately, predictions of when and how domestic policy in China will change have never been easy and they are not likely to become easier in the future.

Since the death of Mao Zedong in 1976, China's new moderate leadership has successively increased the role of free markets, encouraged specialized production, introduced the Household Production Responsibility

System (HPRS), and emphasized rural industrialization through medium-scale commercial cities. In factor markets, the commune-based organizational structure has given way to 15-year land leases and the hiring of up to seven outside workers per household. Agricultural prices have been raised substantially to spur marketed surpluses.

As a result, during the five years 1978-83, real income of rural people more than doubled, while agricultural output value increased by 7.2 percent annually. But the dream of 1 billion Chinese consumers of North American farm products proved to be a mirage. Although short-term imports had been necessary to ease the transition to new production patterns, by 1984 China had become a slight net exporter of agricultural products.

Second, China's level of domestic production has shown a remarkable upswing since the widespread adoption of the HPRS. Underlying technological improvements have included increased fertilizer use, a new emphasis on government research, expanded irrigation, and the distribution of improved plant and livestock varieties, all of which have complemented the institutional changes of the HPRS and the liberalization of domestic markets. In addition, for reasons of food security, China has set a goal of self-sufficiency in basic agricul-

■ Several developments suggest caution about expecting large agricultural exports to China. But there are many uncertainties. The eventual balance between production and consumption—trade—in these products depends on many technical, physical, economic, political, and sociological factors. It is important for Americans to take advantage of the new opportunities to observe these developments in China. For we must be prepared for anything.



Bristling with diversity, one household's portion of a former communal rice field points to the individualized decision making under the HPRS.

tural products which has even led it to renege on signed trade accords with the U.S. Thus, even if future weather vagaries cause shortfalls in China's domestic production, it is unlikely that massive importations will occur.

Third, the increasingly open and experiment-oriented government is already testing several new production and marketing strategies to counter the inevitable defects attendant on any new set of rural development policies.

Fourth, for ideological reasons, China is not prepared to embark upon a wholesale effort to identify, create, and rely upon regional specialization along the lines of comparative advantage that would be compatible with large imports by China of agricultural products. This resistance to specialization does limit

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domestic production and increases the likelihood that China will need to import small quantities from time to time. Yet it drastically reduces the possibility of becoming a large-scale importer of feed and exporter of manufactures like Japan.

So Why Study The China Market?

Already, one may ask: Why bother? If everything keeps changing, if China maintains its emphasis on self-sufficiency and marginal exports, if her leaders are experimenting with institutional modifications to correct the inefficiencies in their agricultural sector, and if their ideological barriers to world trade continue to hold sway, why should North Americans continue to follow Chinese agricultural policy at all and continue to hope that China will someday be a substantial market?

- First, the likely continued uptrend in per capita income, particularly in the East and in the cities, will probably cause increased consumption of animal products, implying rising feed demand end-use of China's grain production. If demand increases more rapidly than grain output potential, imports may

become necessary.

- Second, climatic vicissitudes since 1984 have retarded output growth, making China's long-term export-import strategies less predictable. In fact, a substantial reduction of sown area to grain seems to have reduced grain output,

making China a slight net importer again.

- Third, the continuously changing production patterns while limited, imply increased purchases of capital-intensive technology, such as farm machinery and equipment, by China.

- And finally, China is going through a period of experimentation and openness that allow outsiders a rare glimpse into the successes and failures of her unique production and marketing policies. It is perhaps symbolic that the International Association of Agricultural Economists' 1987 symposium on rural development was held not only in Beijing but at the same time as the 13th Party Congress!

What's New in China's Production and Marketing?

The Beijing symposium brought to light several new perspectives on China's production and marketing prospects. On the production side, the marginal value product of labor has gone up substantially. Furthermore, of the women interviewed in a survey in Shanxi Province, over three-quarters welcomed the new economic regime.

Still, against this positive backdrop, which has received most of the press in the West, four problems on the production side have begun to worry government planners. If unsolved by internal institutional reforms, these could force China to import larger amounts of farm products against her will.

The first problem is that the HPRS has run out of steam in terms of the productivity impacts of delegating decision-making power to the household. Holdings are undercapitalized, overly dispersed, and suffer from inappropriate technology and managerial forms.

Second, the government retains a pro-heavy industry policy despite the acknowledged critical importance of increasing agricultural productivity. Since the introduction of the HPRS, direct government investment in agriculture has gone down by half from the already low level of 10 percent of the annual national budget. Current policy depends, rather, on private savings and investment by the households, and on indirect transfers through subsidies and the price mechanism. It is true that, after heavy consumer spending in the period 1978-82, the savings and investment rates of farmers are rising. However, only the government has the means and the collective will to invest in key infras-

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structural public goods like roads and large-scale irrigation improvements necessary for sustained production growth. In addition, the lack of policy to develop comparative advantage is exacerbated by such measures as a grainland conversion tax which induces every local government unit to maintain grain self-sufficiency. The specialized household system, despite its name, does not provide adequate productive diversification; *regional* specialization for internal trade is also essential.

A third factor which impinges on China's ability to feed herself is that up to 12.3 percent of the population (those with per capita annual incomes of less than 200 yuan, roughly \$85 US) are still not fed and clothed adequately. (Other figures report about 100 million people, of which 40 million are under serious food stress.) Despite the overall success of China's development strategy since 1978, there is an urgent need for a new set of separate strategies for this subset of the population, for which the target is to raise per capita incomes—and hence spending power—to 500 yuan/year by the year 2000. And, even if new production patterns are developed, they must be ecologically sustainable.

This leads to a fourth factor which may limit China's ability to feed herself: a grave grassland crisis in outlying pastoral areas. The rapid increases in the output values of meat and milk during the period 1982-86 have led to ecological pressure, and a need to readjust animal and land allocations based on relative family sizes in 1978. There are also marketing problems, with the herdsmen keeping the best wool for their own inefficient factories and sending off second-grade wool to Shanghai, where quality problems have diminished sales and export earnings. The basic problem: herdsmen do not have confidence that the current policy system will last, and are trying to make as much short-term profit as possible.

In view of these four problems, China will be forced either to import more food, or implement a series of social experiments. To the extent that the latter do not close the gap, China *may* become a net importer of substantial quantities of grain.

Aware of the cost that could be associated with large imports, the regime has encouraged economic studies and pilot projects in the four following areas:

- Economies of scale. The average Chinese landholding is little more than an acre, and may even then be scattered among several fields. Outmigration, consolidation of holdings through land exchanges sanctioned by the township, and appropriate technology changes could bring about some economies of scale. But labor-intensity remains so great that the extent of such economies probably remains small. Indeed, although land consolidation could in principle generate significantly greater output from land resources, it seems unlikely that factor proportions and capital intensity will change enough so that the government can rely with confidence on this strategy.

- Cooperativization. Various types of voluntary cooperatives are thriving in China. Chinese economists now state that the communes of the period 1957-76 were a *divergence* from the normal size of cooperative units. Coop structure is now more flexible, depending on locality, number and type of products included, and market function. For example, in 1986, more than 1700 specialized dairy producers associations pooled all the assets of their members. Thus, there is probably more hope that this strategy will yield the desired effect of reducing

risk, pooling capital equipment and expertise, and stimulating production. One has only to look at Chinese populations elsewhere in Asia to realize that the spontaneous cooperative tradition can aid significantly in improving economic efficiency.

- Appropriate technology. Numerous studies by Chinese agricultural economists argue for reducing the labor input while increasing capital inputs to agriculture. As yet, however, these studies remain theoretical, and little has been done to develop and extend specific technologies on a massive scale

to those farmers responsible for most of the country's production.

- The out-transfer of surplus labor from agriculture to rural-based industry. These industries could in theory absorb excess rural labor, prevent

massive migration to large cities, and provide appropriate modern technology to agriculture. But problems in the quality and quantity of output, as well as pollution and excessive energy consumption call into question the survival of this rural development strategy. Additionally, high wages in these industries have depressed incentives for agricultural production, initiating a vicious cycle of lack of supply of raw inputs for processing. Nor is it clear that these industries will provide a sufficiently high rate of return on investment to attract peasant savings, a vast reservoir of underutilized capital.

Attention to Marketing

On the marketing side, private traders have been operating side by side with government agencies since 1983. Now, the number and extent of free trade areas have been expanded to include three provinces: Fujian, Guangzhou, and Hainan Island. These Special Economic Zones (SEZ) are earmarked for experiments in international trade and economic liberalism of the type already seen in other parts of East Asia. The outside observer (or potential investor) should note two caveats, however. First, China's transportation infrastructure is still underdeveloped, making specialization for trade difficult. And, as noted, China is going through an experimentation stage. If the SEZ fail to attract sufficient trade, the government could close the free trade areas as soon as the next day, and support its decision with a host of ideological justifications.

Ideology versus Economics: The Defense of Prosperity

In fact, the real key to interpreting the evolution of China's production, marketing, and trade prospects is the realization that China is not only a developing economy, but also a Socialist state with a potentially vocal Left within the Communist Party. This duality has led, on the one hand, to the generally successful reforms noted, and on the other, to painstaking efforts by the government to defend those reforms, often before the fact, against possible criticism from leftist ideologues. Such defense of success would seem anomalous in other developing countries where the defense of failure is more the norm.

The Deng regime has developed four ways to justify their social experimentation. The first approach points to *contradictions* in previous policies. For example, current leaders justify the HPRS by noting that the commune system provided little incentive to work hard. A common saying during the com-

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Buzzing with bargaining and good cheer, free markets were re-established in 1978 as a stimulus to marketed surpluses and specialization. Photos by Peter H. Calkins.

mune period was: "energetic as dragons on the private plot, sluggish as worms on the public field" because people learned from collectivization to do just enough to get by. By contrast the reformist economist Lin Zili predicts for the new period that China's "comprehensive reform in the economic system will impart to our socio-economic activities an abundant motivation...and hence, high efficiency and profitability."

The second justification technique has been direct *quotation* of Marx-Leninist classics. For instance, the hiring of up to seven workers by a given household can be justified against possible charges of labor exploitation by a citation from Marx: if a man hired eight others, the basic relations of production would change!

The third justification technique involves a more detailed *redefinition* of what socialism really means. For example, Marx did not talk of the socialist stage between capitalism and the communist Utopia. It was Marx's followers who specified the intervening stage. Now the Deng reformists, in their 13th Party Congress, have identified a "primary substage" within the socialist period, through which China happens to be going. During this substage, markets, profits and material incentives are still necessary, as a holdover of the motive forces of the preceding capitalist period. In addition, it is necessary to tailor the primary substage to the society in question; in this case, to build "socialism with Chinese characteristics."

A final ideological technique is the admission of China's *experimentation* with policies will inevitably produce mistakes such as occurred in the past. This position contrasts with the omniscient attitude of the Mao period and the recurring necessity of finding and blaming scapegoats when things went wrong. China's leaders are careful to stress that only time will tell what works and what is correct. For example, Du Runsheng, Director of the influential Office for Rural Policy Research, has said: "The problem is that we lack experience in building socialism. If the present sets of policies had been practiced earlier, China would have developed faster."

Lessons

What conclusions can one draw from this brief review? First and foremost, North American officials, business people, and academics must be prepared for anything: the emphasis on experimentation and the complex systems of justification will allow China to explain away even massive overnight changes.

Second, it bears repeating that a significant part of the motivation for China's policy changes is ideological justification. For example, the overriding characteristic of the State budget remains a USSR-style over-investment in heavy industry, with only 5 percent of the budget going directly to the agricultural sector. This heavy normative emphasis has much less to do with economic rationality as we know it than with placating the conservative Left within the Communist party. And it influences not just agricultural policies but also the academic research done to buttress and test those policies.

North Americans must be prepared for anything.

Third, China is the way it is not only because it is socialist, but also because of its 40 centuries of culture and history. Throughout this time, the overriding goal has been continuity of values and dynasties, not economic development. In this light, a complex balancing act to maximize the ascendancy of the Deng group becomes completely logical.

Finally, China is also a populous country which, for reasons of both cultural pride and food security, cannot follow some of its East Asian neighbors in becoming dependent on feed-grain imports. Thus, the dream of the "China market" will likely not become a reality for North American producers of agricultural commodities.

